DOW THEORY LETTERS, INC.

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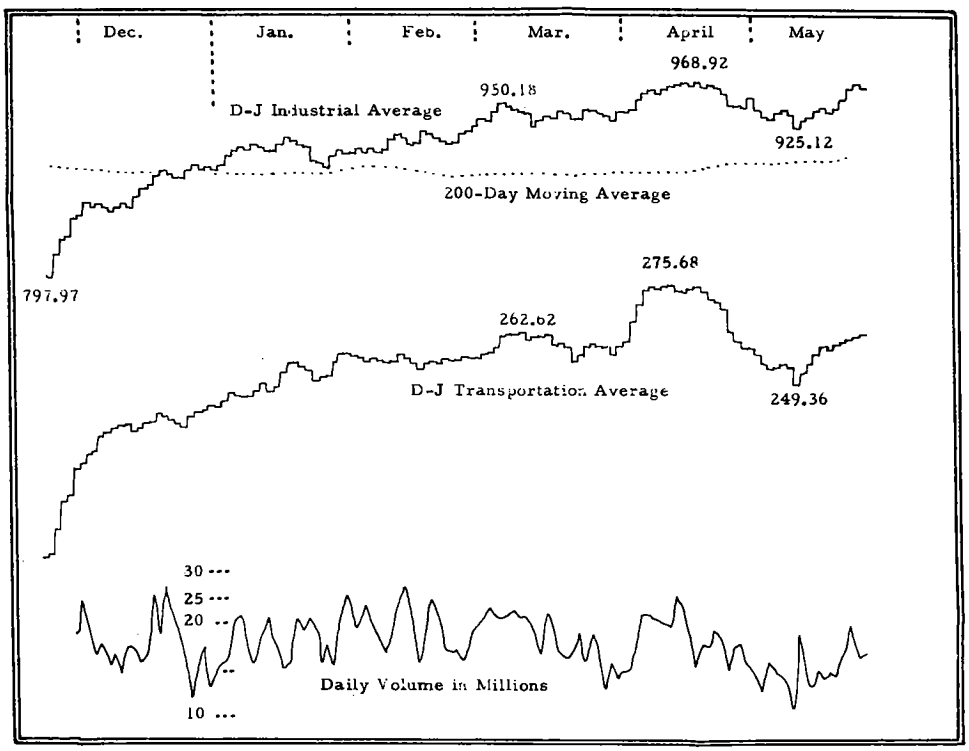
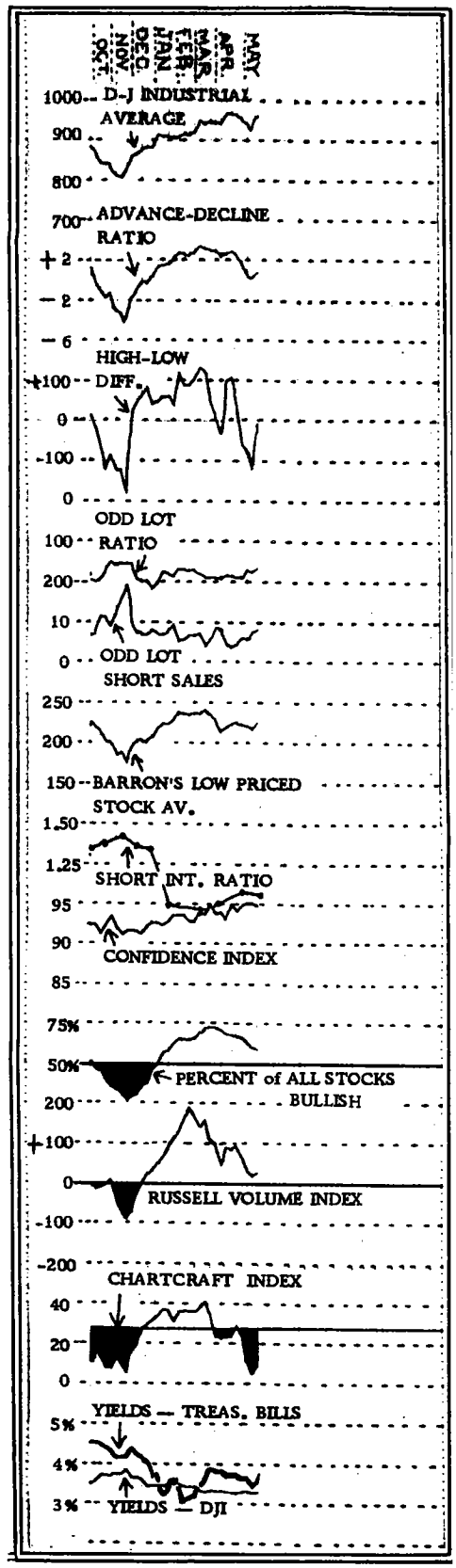
THE MARKET: In the last Letter I noted (referring to the page 2 weekly chart) that while the D-J Industrial and Transportation Averages were relatively strong, the Utility Average and the advance-decline ratio were weak and were in no position to confirm the upside movement of the other two. This situation was borne out when, on May 19, the Utility Average broke to a new 1972 low. As seen on the latest weekly chart (page 2), the "split" in the two pairs of indicators continues unabated, with Transports perhaps ready to join the "weak" list.

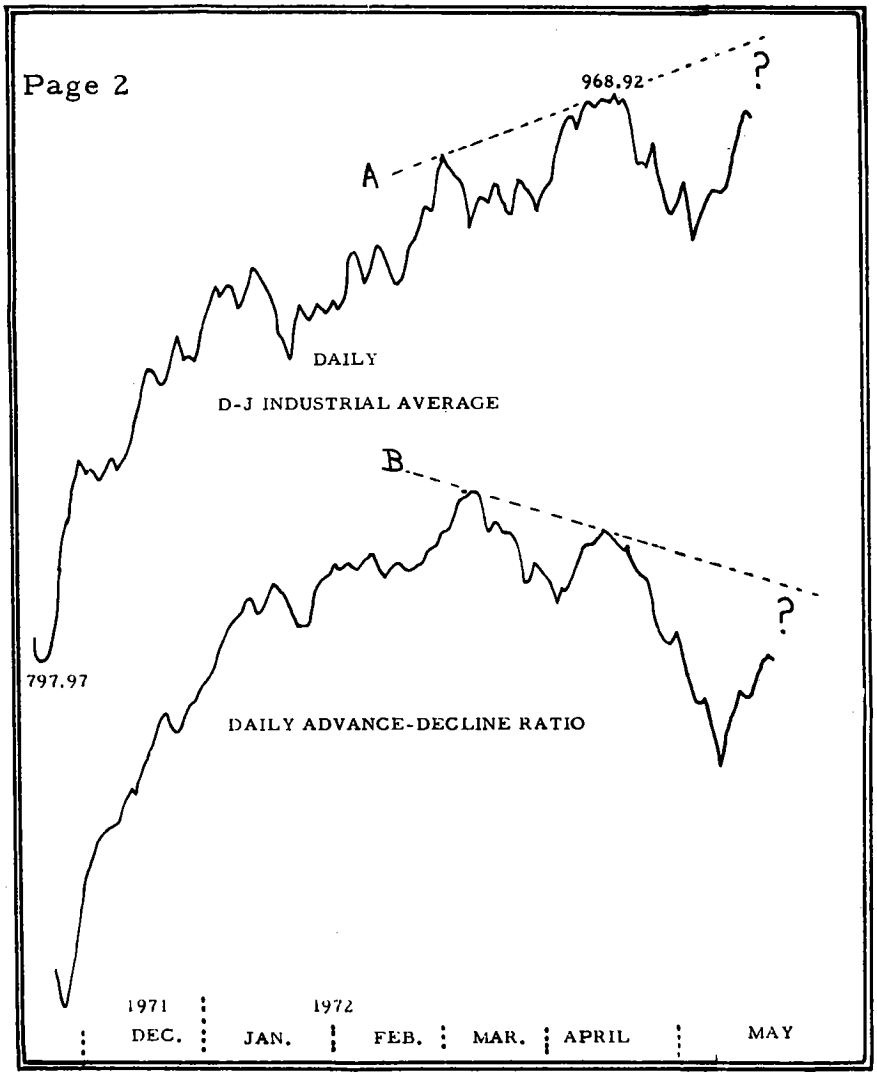
I also stated that the quality of the advance from the May lows will tell us much about this market, and so far I feel the quality has been sub-standard. As seen on the daily chart at the bottom of this page, the Transportation Average was actually the percentage leader on the advance from the 1971 lows (the chart is drawn to ratio scale so all movements can be compared in percentages). But now, for the first time since the advance began, the D-J Transportation Average is lagging. I consider this phenomenon to be most significant, particularly in the face of the outstanding sluggishness on the part of the Utilities and advance-decline ratio.

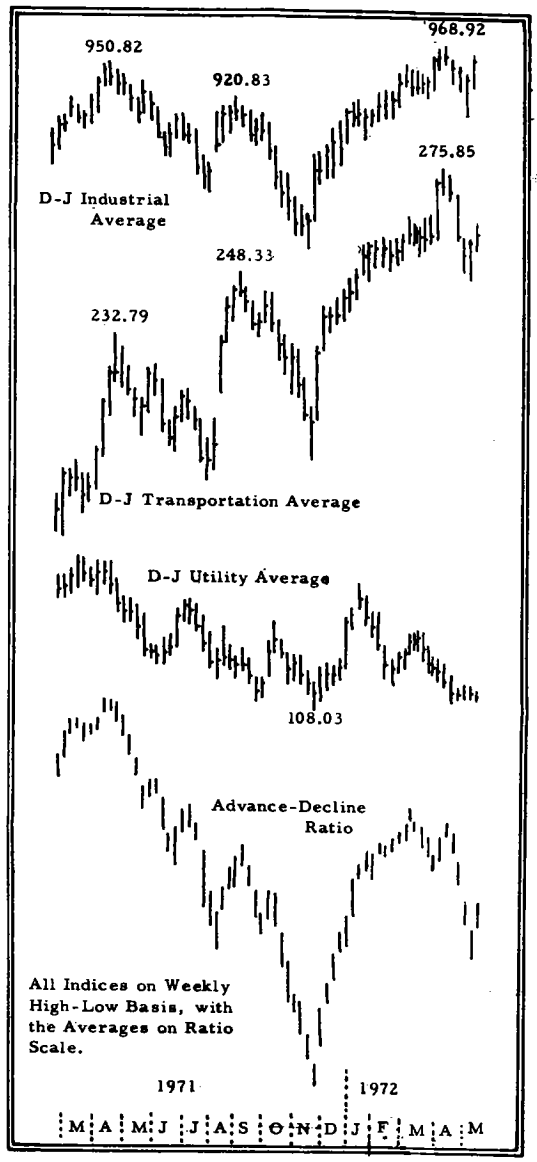
Thus, more and more, the Dow Industrials are out on a limb on this rise from the May, 1972, lows, and it will be most interesting to see what happens if the Dow succeeds in rallying above its April peak of 968.92. I say this with particular reference to the relationship between the Industrials and the A-D ratio.

Study the daily A-D ratio chart on page 2. Note that trendline A on the Industrial Average connects the March peak of 950.18 and the April peak of 968.92. A new recovery high would complete a triple series of ascending peaks. Now note that trendline B on the A-D ratio connects the February high and the lower April peak. With the A-D ratio in its present position, any new recovery high on the Dow (above 968.92) would be sure to produce a series of three descending peaks in the A-D ratio. In the past, such "triple divergences" have been preambles for trouble ahead. Thus the Dow A-D ratio relationship is building up to probable major trouble before the second quarter of 1972 is over.









I feel that the majority of stocks have now seen their tops for this rise, and that the best we will see from here on is sporadic and news-induced rallies, timed to pronouncements from Washington and based mainly on developments in Vietnam. Against this, I believe the market has now fully discounted the best that can be seen ahead for business, while at the same time it is at least aware of the possibility of important trouble on the monetary front.

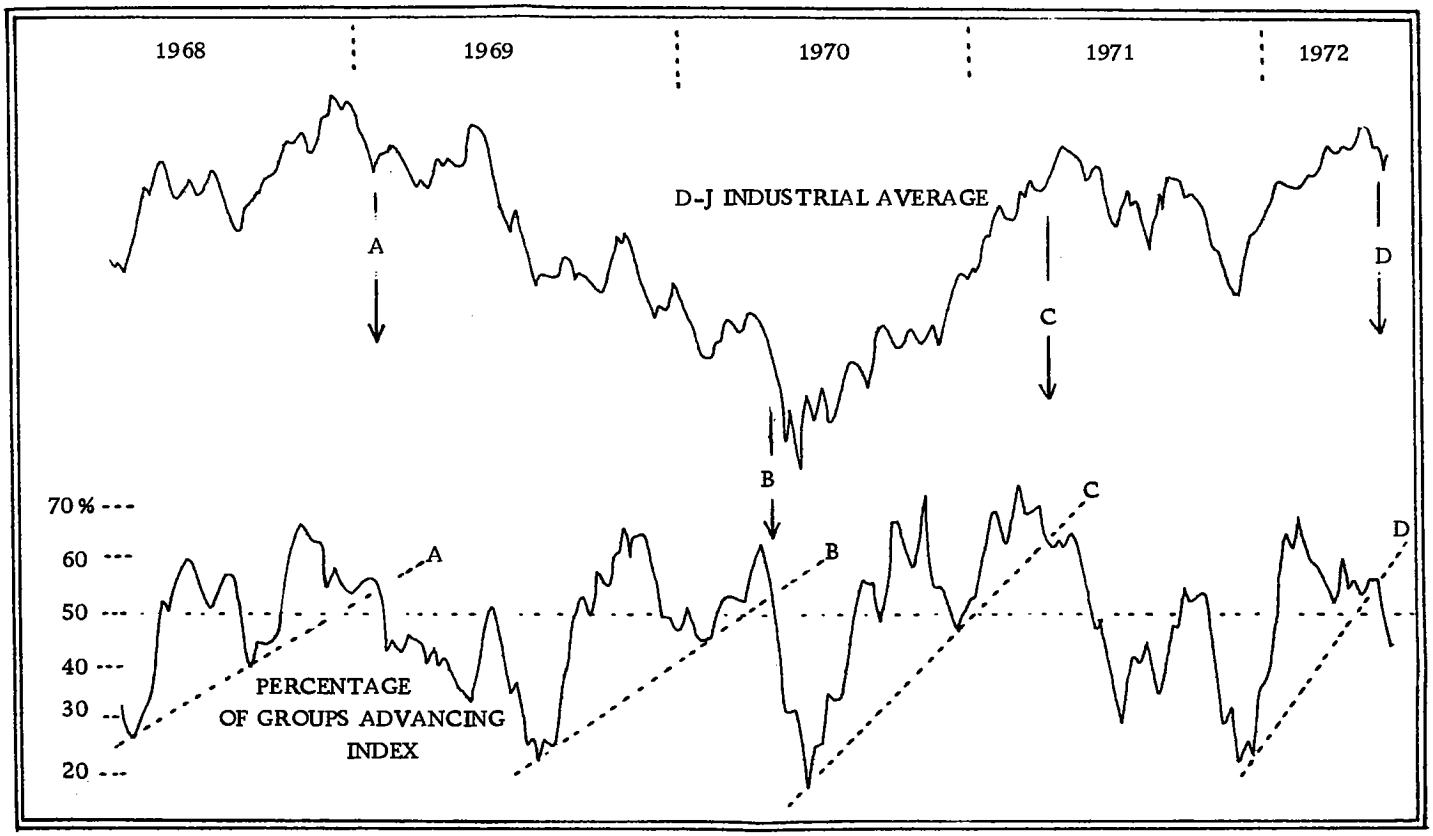
It should be remembered that much of today's so-called "prosperity" is due to inflation, and inflation has only been made possible at the expense of the dollar and the international reserve position of the US. In other words, the upturn in the US economy has been obtained at the cost of this nation's facing a crisis in its monetary position, a crisis which it still has not even begun to face.

Obviously, the US will have to confront the fundamental problem of its run-down in reserves, its mortgaged gold, its inconvertible money, its endless inflation, its chronic balance-of-payments deficits and its total lackofinitiative and leadership on all these fronts.

GROUPS ADVANCING: One of the studies which I keep is based on the percentage of stock groups advancing. Each week Barron's lists 35 stock groups (I delete gold, which tends to be counter-cyclical). I add up the number of groups which have advanced for that given week, and divide by 34. This gives me the percentage of groups which advanced for the week. Then I run an eight-week moving average of the percentage of groups advancing, and that is the index shown on this chart.

The chart on page 3 has been excellent for identifying tops. I do not find it particularly useful in calling bottoms. For purposes of catching tops, I note that a downward zig-zag is important. I draw a rising trendline through the last two bottoms as shown on the chart, and at the point at which the trendline is broken, a first bearish signal is given. These points are also marked by the four arrows under the Dow Industrial Average. A second signal is given when the index drops below zero, indicating that less than 50% of the groups are advancing.

The first signal (identified as "A" on the chart) occurred in early 1969, and this caught the crushing 1969-70 decline very neatly. The next signal (marked "B") came near the final 1970 collapse, a sort of second and late signal for the 1969-70 affair.



Signal "C" occurred just before the 1971 top, and subscribers who wish can re-read the description of this signal in the April 23, 1971, report (Letter 494). Signal "C" was followed by a 153 point decline in the Dow.

The latest signal was given in mid-April, 1972, and just two weeks ago the indicator dropped below the zero level (this is signal "D"). Since this study does not provide any basis for gauging the duration or extent of a coming decline, we cannot draw any detailed conclusions from the latest signal. We do know, however, that the groups advancing index has rendered its two bearish signals and that less than half of the Barron's groups are now in an advancing stage. This situation has preceded all the major declines for as many years as I have records of the index.

THE PROBLEMS GROW: A number of years ago, when writing of Vietnam in these reports, I stated that when a person or a nation goes off in a wrong direction and stays on that wrong direction, nothing but troubles and problems can result. Vietnam has always been a supreme example of this principle.

The mining of North Vietnamese harbors, as I wrote in the last Letter, will not stop the war. But what it has done is brought Russia and China closer together, and it is now known that the Chinese are cooperating with Russia in bringing Russian war goods to North Vietnam via Chinese railroads. Who would have thought it possible?

Meanwhile, with blustering Treasury Secretary Connally out, new Secretary Shultz will have to bear the Administration's monetary burdens. And one of those burdens will be dealing with a Common Market which will insist on calling the shots in the gold picture. Complicating the situation immensely will be Russia. Russia dreams of being a monetary power, and she will use her gold-producing facilities in an attempt to get there. It is costing Russia $80 to $100 per ounce to produce gold. Obviously she wants a major boost in the gold price.

All of Russia's interests will be served by her joining with Europe in the gold war against the US. For if a big jump in the gold price is obtained, Russia may make the ruble convertible. In fact, Russia may even align in a formal monetary arrangement with Europe, all this in the face of a mortgaged, inconvertible and toppling dollar. Obviously such a series of events would lift Russia a few enormous steps up in the world power structure, while the US would sink a few major steps down ("a few" is putting it mildly).

Reserve Board Chairman Burns must sense the mess abuilding, and his recent "10 point" plan for the dollar was nothing but a plea for the Nixon Administration to get out of its armchair and get moving before we are "moved" by our creditors in a manner which may well border on the humiliating.

I have been insisting that the US situation on the monetary front was intolerable and that our "formula" for solving the problem was arrogance, blindness and jawboning. All the while events have been militating against us, and we have been compounding a series of gross errors. None of this has been lost on Russia. The Russians have been waiting patiently for the best time to exploit our stupidity on the monetary front, and that time is drawing close. Gold will be the barometer, and the price of gold has been booming. This Fall could bring many surprises, and the shots will be called increasingly by those who (1) want to protect themselves against the deteriorating value of the dollar, or (2) those who have a vested interest in defeating the US on the economic front.

After writing this section I received the latest report from Dr. Harry Schultz, and I must admit to shock. My friend Harry Schultz is a highly intelligent, well informed man, and I have seen many of his seemingly "far out" predictions come true. It was therefore almost horrifying to read the opening of his latest report:

"The US is through as a dominant world power. A new world without America is rapidly emerging, and it will be that world which will increasingly dominate human events in the last quarter of this century. The eclipse of the US is proceeding at a speed unprecendented in world history. Gibbon's classic, 'The Decline and Fall of the Roman Empire,' had to cover centuries. The inevitable future classic, 'The Decline and Fall of America,' will have only a few decades to deal with. . . . The disintegration of America is on all fronts; it is falling apart as a military force, as an economic and as a monetary force and as a moral force. It stands today in the world's eyes as a nation willing, able and apparently hellbent on blowing itself to bits as a society. . ."

Schultz goes into detail showing how Mr. Nixon is now reduced to the position of running around the world, trying to get other superpowers to do, undue or rectify the US's mistakes. Schultz talks about how the other nations want to get rid of dollars, rather than being "pulled down with America." How do I feel about what Schultz is saying? It doesn't do any good to say that "I pray that Schultz is wrong." I feel that we are being blind, we're doing the wrong things, we're making the wrong moves . I also believe in trends. Schultz will be wrong if America reverses its present course — on all fronts. I see no signs of that yet, no hint of it.

GOLD: The US politicians and the public are still in dreamland regarding the world monetary picture and the role of goal. Not to be left out are the newspapers, as witness the enclosed clip from the May 15 Los Angeles Times (which is still blaming the rise in gold on industrial demand).

Industrial Demand Sends Gold Price to Record $55 an Ounce

LONDON (AP)—The price of gold soared to record levels on European free markets Tuesday, reaching a peak in London of $55 to $55.50 an ounce.

In brisk trading, the metal also [illegible] new highs in Zurich [illegible]

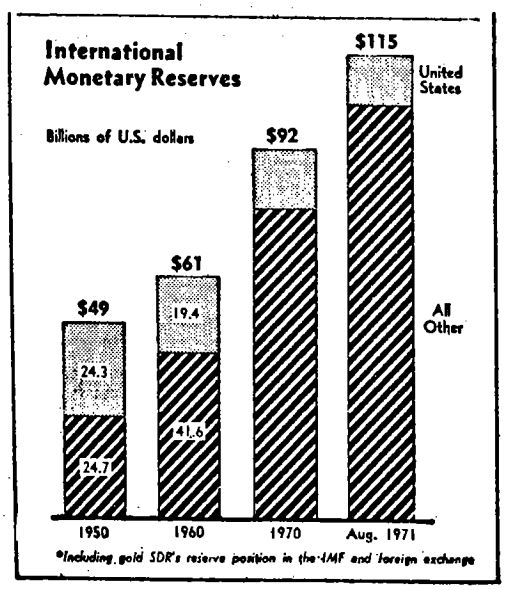
that with demand trailing supply and inflation, gold could top $85 an ounce by 1980.

The official price of gold is $38 an ounce.

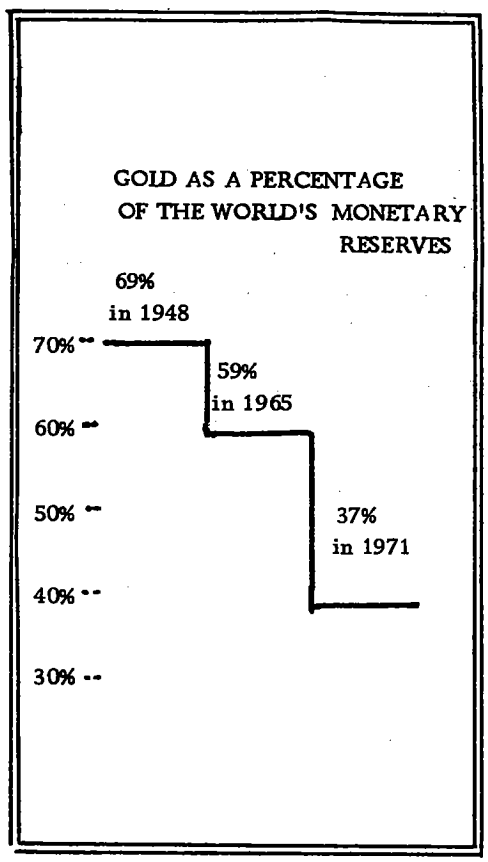
Gold cle[illegible]

The facts are too numerous to mention, but it is worth noting that world liquidity resources (not including gold) rose dramatically during the last decade. European (and Japanese) dollar holdings invested in US short-term obligations have gone through the roof, and as often reported here, are estimated to be over $60 billion. That $60 billion represents six times the amount of gold available in US reserves.

A more graphic picture of the international monetary predicament can be seen in this chart of international reserves. Here we see world monetary reserves climbing from $49 billion in 1950 to $115 billion in 1971. That represents a rise of over 130%. During this same period, the rise in actual gold reserves by the nations of the world has been sluggish. Gold is not as easy commodity to mine, and we might remember that since the dawn of civilization only 73,000 tons of gold have been mined!



Therefore, I include a second chart which shows gold as a percentage of the world monetary reserves. Here we see one of the vital elements of the world monetary problem. There are some who say that gold should not be used as the core of the world's monetary system because there simply is "not enough gold". This argument is absurd on the face of it. There has always been enough gold, quantitively. All that needs to happen is a periodic



revaluing in the price of gold. Since this has not occurred since 1933 (I am excluding this year's ridiculous $3 boost by the US), the free market is saying that events are forcing a major gold rise upon us.

A few other factors have to be faced. The longer the US pursues its do-nothing policy regarding inflation and its payments balance, the greater the ultimate rise in the gold price will have to be. Second, a rise in the price of gold will not alone solve the world monetary problem. The world needs an international currency it can trust (which means a convertible, gold-backed currency), and the US needs to put itself in position where it will stop running up astronomical deficits.

Meanwhile, it appears (as I have been warning it would) that the free gold market will no longer wait for the US or anyone else to make up their minds. The price of gold is heading higher literally daily. For the gold market knows that there are only two questions. The first is how high the price of gold must be set in order to stabilize the international monetary picture. The second is whether the final major upward valuation will come by intelligent agreement or during the midst of a monetary and financial crisis.

I have been alerting subscribers to the fact that Europe is no longer waiting for the US to come forth with a monetary plan. Europe is now readying its own plan, and it is also rumored that Europe will include its own form of gold-backed currency. All this occurring amidst the mumbling of Dr. Burns of the Federal Reserve Board and Mr. Volcker of the Treasury (both of whom are probably shaken as they see the center of monetary power shifting rapidly towards the other side of the Atlantic).

Finally, Mr. Connally, our former Treasury chief, has seen this as the perfect time to exit from Washington. He never understood the international monetary picture, he never understood gold, but he seems to understand only too well that a wise man knows when to beat a hasty retreat.

At this point I want to say something about Mr. Nixon and gold. To my mind, barring some sort of horrendous crisis it would appear that Mr. Nixon will stay in office. Now the first term of office for an American President is often an amalgam of nonsense and compromise because he is thinking of giving the people "happiness" so he can get elected for a second term. Mr. Nixon has followed that course faithfully, and if there is a campaign pledge which he has not reversed, I don't know what it is.

But during the second term an American President starts thinking of his place in history, and often at the cost of popularity he gets down to serious business. The international monetary business is a serious business, and it is working towards a crisis. American finances are already in a bad way, and Mr. Nixon is definitely, without a shadow of a doubt, going to have to deal with that crisis — if it waits as long as election-time, 1972. Mr. Nixon is going to have to do something about repricing gold, or gold is going to be repriced without him.

Prone as he is to reversing himself completely, it would not surprise me to see Mr. Nixon come out with a startlingly high suggested price for gold, say triple the current "official" US price of $38. Along with this, he would have to institute higher taxes and a major anti-inflation program which would work. He would also have to stop the monetary printing presses, and start talking hard, cold facts to the American people. All this will have to be done during the next year — probably after election. If not, it will be forced upon us.

Meanwhile, the gold stocks seem to be sensing the coming changes. In order to show what was actually occurring on the gold equity picture, I have (see page 6) used long-term (monthly) charts by M.C. Horsey, Salisbury, Md. 21801. It is immediately apparent from the trendlines I have drawn that these three major listed gold equities have broken out of large triangle patterns. Since the breakouts were on the upside, we now know that the triangles represented major areas of accumulation. Everything is now working for the gold shares. Jim Dines' gold momentum chart has turned bullish, the relative strength of the group has turned bullish from a low area (see chart), and the areas of accumulation in the actual stocks are large enough to support moves to and above the old highs. All this may take time, but we have been patient with our gold hedges so far, and there is no reason why we cannot continue to be so.

Special: Profit report on selected South African gold mines. Following are percentage changes for the quarter ending March, 1972, compared with the quarter ending March, 1971.

Blyvoors	plus 25%	Pres. Brand	plus 26%
Elsburge	plus 69%	Pres. Steyn	plus 45%
Free State Geduld	plus 19%	Welkom	plus 45%
Hartebeest	plus 55%	Western Areas	plus 82%

Page 6 At the bottom of the page I have shown Barron's Gold (group) average together with the relative strength of the Gold Group compared with the Standard & Poor's broad Stock Average. As seen on the chart, the Group price is now in the process of breaking out above the 1969 high, and heading for the 1968 (not shown) all-time high. Encouraging is the fact that the relative strength line is reversing to the upside from a two-year low.

Finally, I have included this clipping from last week's Wall Street Journal to the effect that Japan wants to reduce its swollen foreign reserves. Now the Japanese are a very polite people. They are announcing that they want to reduce reserves including gold and foreign currencies. I will translate: Japan wants only to get rid of it mountain of dollars. Get rid of their gold? Just ask the Japanese bankers if they would trade their dollars in for gold (if they could) and see what they say! How long will this kind of international politeness last? I don't know, but I would guess not much longer.

Japan Seeks Cut in Gold, Foreign Money Reserves To Less Than $10 Billion

Special to THE WALL STREET JOURNAL

TOKYO — Japan wants to reduce its gold and foreign currency reserves to below $10 billion from $16.54 billion at the end of April, Kakuei Tanaka, minister of international trade and industry, said.

In a conference with foreign newsmen, he said the cut is a principal intent of a government program announced over the weekend for restricting exports and spur imports to narrow the surplus in Japan's international payments account.

Mr. Tanaka didn't say how long it would take the government to reach the $10 billion reserve goal.

U.S. Trade Deficit Seen Widening From '71 Record

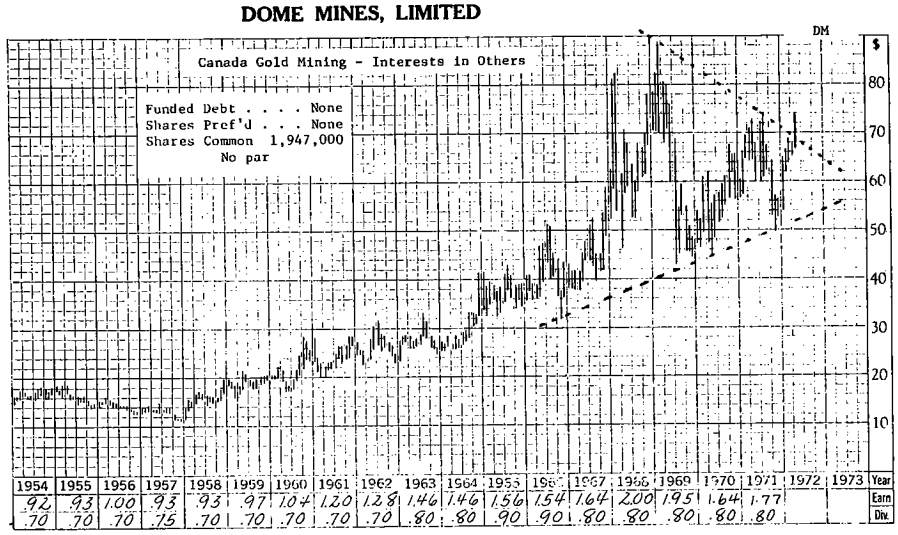
By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—The U.S. foreign trade deficit this year will widen from last year's record $2.05 billion, Edward L. Allen, deputy assistant Commerce Secretary for international economic research, predicted.

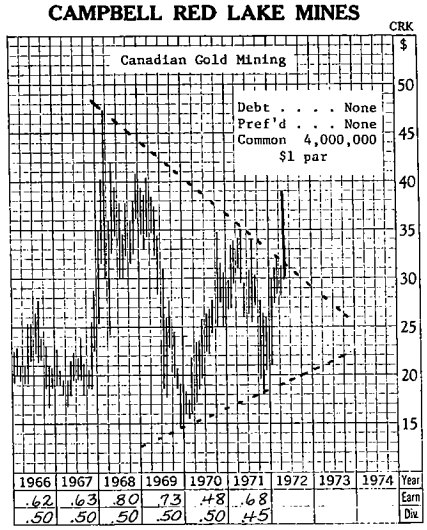
Mr. Allen's forecast is more pessimistic than trade projections by other government officials, who generally have indicated that the deficit, incurred when U.S. imports exceed exports, should narrow.

From our "I see it, but I don't believe it" Dept.

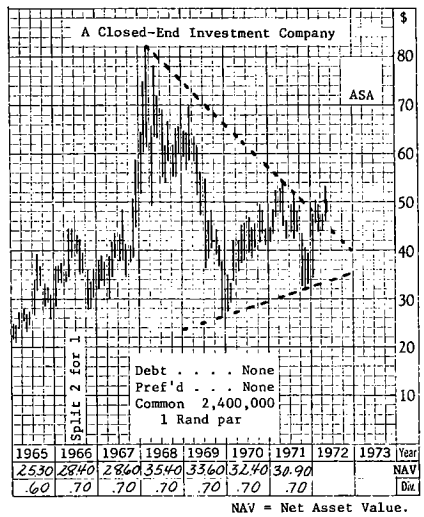
DOME MINES, LIMITED



CAMPBELL RED LAKE MINES



AMERICAN - SO. AFRICAN INV. CO.



NAV = Net Asset Value.